MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) Which of the following is a bank liability?
   A) reserves   B) consumer loans
   C) securities   D) nontransaction deposits

2) Loans by the Federal Reserve to banks are known as
   A) cash items in the process of collection.   B) Federal funds.
   C) repurchase agreements.   D) discount loans.

3) In what sense can a reserve requirement be said to be a tax on bank intermediation?
   A) Banks are unable to lend out all their deposits.
   B) Banks must pay tax on any funds deposited in a reserve account at a rate equal to the applicable corporate income tax rate.
   C) Banks must pay tax on any funds removed from a reserve account at a rate equal to the applicable corporate income tax rate.
   D) Banks must pay taxes on the amount by which the fail to meet their reserve requirements.

4) If you deposit $100 in your bank and the required reserve ratio is 20%, your bank will have
   A) an increase in required reserves of $20 and an increase in excess reserves of $80.
   B) an increase in required reserves of $500.
   C) an increase in required reserves of $80.
   D) an increase in required reserves of $100.

5) Credit risk is the risk that
   A) an insufficient number of borrowers will apply for loans or credit.
   B) borrowers might default on their loans.
   C) interest rates will fall after a loan has been granted.
   D) interest rates will rise after a loan has been granted.

6) Banks experience interest rate risk
   A) if moral hazard problems are particularly severe.
   B) on any investment that has high information costs.
   C) if adverse selection problems are particularly severe.
   D) if changes in interest rates cause bank profits to fluctuate.

7) A bank’s net worth will decline following an increase in interest rates if the value of its
   A) fixed-rate assets is greater than the value of its variable-rate assets.
   B) fixed-rate liabilities is greater than the value of its variable-rate liabilities.
   C) fixed-rate assets is less than the value of its fixed-rate liabilities.
   D) fixed-rate assets is greater than the value of its fixed-rate liabilities.
8) A bank that expects interest rates to fall will
   A) want the duration of its assets to be less than the duration of its liabilities’ positive duration gap.
   B) want the duration of its assets to be greater than the duration of its liabilities’ negative duration gap.
   C) want the duration of its assets to be less than the duration of its liabilities’ negative duration gap.
   D) want the duration of its assets to be greater than the duration of its liabilities’ positive duration gap.

9) Which of the following is a liability of the Fed?
   A) U.S. government securities
   B) checkable deposits in commercial banks
   C) discount loans to banks
   D) currency in circulation

10) The percentage of deposits that banks must hold as reserves is called the
    A) percentage rate.
    B) required reserve ratio.
    C) discount rate.
    D) Fed rate.

11) The interest rate the Fed charges on loans to depository institutions is known as
    A) the interbank clearing rate.
    B) the Fed loan rate.
    C) the discount rate.
    D) the federal funds rate.

12) Open market operations involve
    A) the Fed buying and selling U.S. government securities.
    B) the Fed buying and selling common stock in order to affect the liquidity of the stock market.
    C) the Fed making discount loans to depository institutions.
    D) private investors buying and selling securities directly on exchanges, rather than through brokers.

13) If the Fed purchases $1 million in securities from the nonbank public, the monetary base will rise by $1 million
    A) whether the public holds the proceeds as currency or deposits them as checkable deposits.
    B) if the public deposits the proceeds with the Treasury in a monetary base account.
    C) if the public holds the proceeds as currency.
    D) if the public deposits the proceeds as checkable deposits.

14) A $10 million open market purchase will increase bank reserves by
    A) $10 million divided by the money multiplier.
    B) $10 million.
    C) an amount between 0 and $10 million, depending on the fraction of the purchase the public wishes to hold
       as currency.
    D) $10 million times the money multiplier.

15) In managing the monetary base, the Fed most often uses
    A) printing money.
    B) discount loans.
    C) open market purchases.
    D) tax increases.

16) Suppose that a bank with no excess reserves receives a deposit into a checking account of $10,000 in currency.
    If the required reserve ratio is 0.20, what is the maximum amount that the bank can lend out?
    A) $2000
    B) $50,000
    C) $10,000
    D) $8000

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17) Suppose that the banking system currently has no excess reserves and that a bank receives a deposit into a checking account of $10,000 in currency. If the required reserve ratio is 0.20, what is the maximum amount that the banking system can lend out?
A) $8000 B) $50,000 C) $40,000 D) $10,000

18) Which of the following assumptions made in deriving the simple deposit multiplier is unrealistic?
A) The Fed is able to affect the level of reserves in the banking system.
B) The simple deposit multiplier is equal to 1 divided by the required reserve ratio.
C) The Fed sets the required reserve ratio.
D) Banks loan out all of their excess reserves.

19) Holding other things constant, the currency-deposit ratio will
A) increase as income or wealth increases.
B) decrease as income or wealth increases.
C) increase as income increases, but decrease as wealth increases.
D) decrease as income increases, but increase as wealth increases.

20) The currency-to-deposit ratio will rise when
A) the anonymity premium declines. B) the expected return on deposits rises.
C) the fear of bank runs declines. D) the level of underground activity increases.

21) When banks hold excess reserves,
A) the size of the money multiplier becomes infinite.
B) the size of the money multiplier is less than the simple deposit multiplier would suggest.
C) the size of the money multiplier is equal to the size of the simple deposit multiplier.
D) the size of the money multiplier is greater than the simple deposit multiplier would suggest.

22) Members of the Board of Governors are
A) elected by the district bank presidents.
B) appointed by the President of the United States, subject to confirmation by the Senate.
C) appointed by the Securities and Exchange Commission, subject to congressional veto.
D) appointed by the National Monetary Commission.

23) The Chairman of the Federal Open Market Committee is also
A) the chairman of the Federal Deposit Insurance Corporation.
B) the chairman of the Securities and Exchange Commission.
C) the chairman of the Board of Governors.
D) the president of the Federal Reserve Bank of New York.

24) Which of the following statements is correct?
A) Open market purchases are contractionary and open market sales are expansionary.
B) Open market purchases are expansionary and open market sales are contractionary.
C) Both open market purchases and open market sales are expansionary.
D) Both open market purchases and open market sales are contractionary.
25) Under current Fed practice, changes in policy made by the FOMC  
A) are announced six weeks after they are made.  
B) are announced at the time they are made.  
C) must be approved by a majority of the presidents of the Federal Reserve district banks.  
D) must be approved by the Secretary of the Treasury.

26) An increase in the volume of discount loans  
A) decreases both the monetary base and the money supply.  
B) increases both the monetary base and the money supply.  
C) increases the monetary base but decreases the money supply.  
D) decreases the monetary base but increases the money supply.

27) Which of the following statements is NOT true?  
A) Before 1980 the Fed rarely made loans to banks that were not members of the Federal Reserve System.  
B) An increase in the volume of discount loans reduces the monetary base.  
C) Each Federal Reserve bank maintains its own discount window.  
D) Since 1980 all depository institutions have had access to the discount window.

28) Which of the following is an intermediate target?  
A) M1  
B) federal funds rate  
C) Reserves  
D) inflation rate

29) The premise of the quantity theory of money demand is  
A) the store of value function of money is more important than the medium of exchange function of money.  
B) it is only the quantity of money, and not its quality, that counts.  
C) only gold and silver coins have value.  
D) the most obvious reason that households and businesses demand money is for use in making transactions.

30) Real money balances equal  
A) M/P.  
B) nominal money balances.  
C) P/M.  
D) MP.

31) Velocity equals  
A) PY/M.  
B) MY/P.  
C) MP/Y.  
D) M/PY.

32) If the quantity of money is $4 trillion and nominal GDP is $8 trillion, velocity is  
A) .5.  
B) 2.  
C) $32 trillion.  
D) not computable unless the value of the price level is given.

33) In order to convert the equation of exchange into a theory of money demand, we need to rewrite it as  
A) P/M = V/Y.  
B) V = PY/M.  
C) M/P = (1/V)Y.  
D) M = PY/V.
34) In the quantity theory of money demand,
   A) velocity is assumed to be constant.
   B) velocity is assumed to vary with the price level.
   C) the demand for real balances is determined by the price level.
   D) the price level is assumed to be constant.

35) The interest rate is a measure of
   A) the opportunity cost of holding bonds.
   B) the growth rate of output in the long run.
   C) the inflation rate.
   D) the opportunity cost of holding real money balances.

36) The most important difference between $M_1$, on the one hand, and $M_2$ and $M_3$, on the other hand, is that
   A) $M_2$ and $M_3$ included assets with greater liquidity than those included in $M_1$.
   B) $M_1$ includes currency, but $M_2$ and $M_3$ do not.
   C) $M_2$ and $M_3$ include assets with less liquidity than those included in $M_1$.
   D) $M_1$ includes checkable deposits, but $M_2$ and $M_3$ do not.

37) The equation of exchange is an identity because
   A) it has been shown empirically to hold in many different times and places.
   B) of the way velocity is defined.
   C) it defines the money supply to be equal to currency plus checkable deposits.
   D) the price level is assumed to be constant.

38) The fact that in addition to being a medium of exchange, money serves as a store of value means that
   A) money competes with other assets in the portfolios of businesses and households.
   B) the demand for real balances should increase more than proportionately with increases in real income.
   C) movements in the interest rate should not affect the demand for money.
   D) movements in the price level should not affect the demand for money.

39) An individual with a high income will probably
   A) hold a larger fraction of her wealth in the form of money than will an individual with a low income.
   B) hold a smaller fraction of her wealth in the form of money than will an individual with a low income.
   C) hold a smaller fraction of her wealth in the form of money than will a large corporation.
   D) hold the same fraction of her wealth in the form of money as will an individual with a low income.

40) Which of the following is true?
   A) The demand for real balances increases less than proportionately with real income.
   B) The demand for real balances increases more than proportionately with real income.
   C) The demand for real balances decreases as real income increases.
   D) The demand for real balances is unaffected by changes in real income.
1) Answer: D
2) Answer: D
3) Answer: A
4) Answer: A
5) Answer: B
6) Answer: D
7) Answer: D
8) Answer: D
9) Answer: D
10) Answer: B
11) Answer: C
12) Answer: A
13) Answer: A
14) Answer: C
15) Answer: C
16) Answer: D
17) Answer: C
18) Answer: D
19) Answer: B
20) Answer: D
21) Answer: B
22) Answer: B
23) Answer: C
24) Answer: B
25) Answer: B
26) Answer: B
27) Answer: B
28) Answer: A
29) Answer: D
30) Answer: A
31) Answer: A
32) Answer: B
33) Answer: C
34) Answer: A
35) Answer: A
36) Answer: C
37) Answer: B
38) Answer: A
39) Answer: B
40) Answer: A